

To buy or not to buy a franchise

By Tim Kilham

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How a specialist franchising accountant can assist you before you decide to buy

We have specialised in franchising for many years now and I have met with many people about buying a franchise. I admire the courage of every person who starts or buys a business, particularly those who have never run a business before – most people will never own their own business and never know what courage it takes to start a business. Many people who start their own businesses are successful, many are not. It is hard work. There is that old saying that the reason you go into business for yourself is so that you can work sixteen hours a day so that other people can work eight hours a day for you!

So it takes courage to buy a business. Further, the process of buying a business can be a confusing and a difficult one. Very often the first question I am asked when I talk to a potential franchisee is “which franchise should I buy?” This is not generally a question I can answer. There are some franchise systems that I wouldn’t touch with a barge pole – no names mentioned in this article! – but most franchisors are honest and reputable and try to ensure that both they and their franchisees make money. However, even in good systems there are poorly performing franchisees. A lot will depend on factors such as the purchase price, the location, how good an operator you are, etc.

The second question that I usually get asked is “What will you do for me and how can you help me?”

The accountant from whom you seek advice should be an accountant experienced in franchising. There is only a small number of accountants who truly know the franchising industry, franchise regulation and are familiar with the commercial aspects of franchising. McLean Delmo is one of them.

Notwithstanding that it is difficult to answer the question “which franchise should I buy?”, if you are considering buying a franchise it would be wise to make contact with us very early in the process. You need to know how much you will be able to borrow to buy your franchise, and we are able to give you a very good idea of your borrowing capacity once your assets and liabilities are known. You could also talk to your bank at an early stage in principle about the purchase of the franchise. Your bank will not give any formal approval until you have put in an application, together with financial projections, but in principle the bank can advise at an early stage what it will be prepared to lend.

Once you have narrowed down your choice to a particular business, or perhaps one or two particular businesses we can assist in evaluating whether it is financially viable and how much you should pay for it.

The information that I like to see when I am helping a potential franchisee evaluate the purchase of a franchise includes:

- accounts and tax returns for the business (assuming it is an existing business);
- current financial information (very often there will be a significant gap between the date you are considering buying the franchise and the date that the last accounts and tax returns were prepared);
- franchisor reports;
- disclosure document;

- franchise agreement; and
- a copy of the lease (if premises are involved).

All of this information, and any other information that you may have gathered, is useful to me in helping to evaluate the franchise opportunity. At the first meeting, I usually review these documents and ensure that you, as the potential franchisee, have a commercial understanding of the process and of franchising. At the first meeting I normally also discuss in broad terms the price being asked, and the likely profit and return on investment. It is not uncommon to find that the price being asked is (in my opinion) totally unreasonable and for me to advise that no further work should be done unless the seller of the business substantially reduces the price.

The second meeting usually involves the preparation of profit and loss and cash flow projections for the business. There are two points to note here:

- For most businesses, both profit and loss and cash flow projections need to be prepared. Profit and loss and cash flow are not the same unless the business pays cash for everything it buys and is paid cash for everything it sells – and that of course is not the case for most businesses.
- The projections need to be prepared in detail on a month by month basis for the first twelve months at least. Projections for future years can be on an annual basis.

Some of the information that is necessary to prepare the profit and loss and cash flow projections is gathered by the potential franchisee between the first and second meetings. Other information will be gleaned from accounts and tax returns and the disclosure document.

The profit and loss and cash flow projections are critical for a number of reasons. If you are going to want to borrow money from a bank in order to buy your franchise, you will have to prepare a business plan for the bank. The most important part of that plan (from the bank's point of view) will be your profit and loss and cash flow projections.

Your projections will tell you what you expect the profit and therefore the return on the business to be. The decision to buy the franchise – or to not buy the franchise – will depend on whether you can make a reasonable return on your investment. The price that you are to pay for the franchise will not necessarily be the price that the seller is asking. The purchase price of businesses is negotiable.

In my opinion, no franchise business should be purchased without preparing financial projections.

By now, at our second or third meeting, you will be in a position to make a decision as to whether to proceed with the purchase or not. It is still not an easy decision. Sometimes the financial return is borderline. Sometimes I find that the potential franchisee is just not ready to commit to buying a business. Some people at this stage simply find themselves unable to make the decision to sign on the dotted line. I have no problem with that. It is better to walk away than to buy the wrong business. As your accountant I will give you advice and tell you what I think but the decision to purchase or not to purchase is always yours.

If you do make the decision to buy, there is much that we can still do to assist you.

You will need to submit a comprehensive business plan to your financial institution, assuming that you are borrowing money to buy the franchise. The profit and loss and cash flow projections will form the core of that business plan, but there is other information that needs to be provided. I always recommend that my clients prepare their own business plans, but I assist when necessary and provide an outline of the plan.

It often helps to use a broker when making an application to a financial institution for finance for your franchise. You can approach the financial institution directly, but using a broker does not cost you anything as the broker is paid by the financial institution. Very often the broker can help you prepare your application and will know which is the right bank to approach. Many accountants have finance brokers working for them, as we do. This can help to make the whole process seamless and trouble free.

The choice of the correct business structure is also important. Options include sole proprietorship, partnership, company and trust. The correct structure – which will depend on your unique circumstances – will help protect assets, minimise income taxes, provide flexibility and minimise capital gains taxes on sale of the business.

Having chosen your new business structure, we will help set it up and ensure that all the necessary registrations are done. These could include: ABN, TFN, PAYG-W, PAYG-I, SGC, GST, etc. However this is another topic in its own right and the subject of another article!

Tim Kilham

Partner

Franchising Division Head

McLean Delmo

Accountants and Business Advisors


302 Burwood Road

Hawthorn Vic 3122

T: 61 3 9018 4666

E: tim.kilham@mcleandelmo.com.au

www.mcleandelmo.com.au



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